

Franchise Tax Board**ANALYSIS OF ORIGINAL BILL**

Author: Berryhill/Huffman Analyst: Jennifer Bettencourt Bill Number: AB 1132
Related Bills: See Legislative History Telephone: 845-5163 Introduced Date: February 23, 2007
Attorney: Douglas Powers Sponsor: _____

SUBJECT: Graywater Irrigation System Credit

SUMMARY

This bill would allow a credit for a percentage of the costs to install an irrigation system utilizing graywater.

PURPOSE OF THE BILL

According to the author's office, the purpose of this bill is to provide a tax incentive to encourage use of graywater irrigation systems.

EFFECTIVE/OPERATIVE DATE

As a tax levy, this bill would be effective immediately upon enactment and operative for taxable years beginning on or after January 1, 2007, and before January 1, 2021.

POSITION

Pending.

ANALYSISFEDERAL/STATE LAW

Existing state and federal laws provide various tax credits designed to provide tax relief for taxpayers who incur certain expenses (e.g., child adoption) or to influence behavior, including business practices and decisions (e.g., research credits or economic development area hiring credits). These credits generally are designed to provide incentives for taxpayers to perform various actions or activities that they may not otherwise undertake. Current state and federal laws do not provide a credit similar to the one proposed by this bill.

THIS BILL

For taxable years beginning on and after January 1, 2007, this bill would allow a personal income tax and a corporation tax credit for a percentage of the costs paid or incurred to install in California an irrigation system that utilizes graywater.

Board Position:	Department Director	Date
_____ S _____ NA _____ NP		
_____ SA _____ O _____ NAR	Lynette Iwafuchi	5/17/07
_____ N _____ OUA _____ X PENDING	For Selvi Stanislaus	

This bill references the California Water Code that defines “graywater” as untreated wastewater that has not been contaminated by any toilet discharge or affected by infections, unhealthy bodily wastes, and does not present a threat from contamination by unhealthful processing, manufacturing, or operating wastes. Graywater includes wastewater from bathtubs, showers, bathroom washbasins, clothes washing machines, and laundry tubs, but does not include wastewater from kitchen sinks or dishwashers.

The bill would specify the percentage of the credit that would be allowed as follows:

For a system installed on or after:	Credit percentage
January 1, 2007, and before January 1, 2012	50%
January 1, 2012, and before January 1, 2015	40%
January 1, 2015, and before January 1, 2018	25%
January 1, 2018, and before January 1, 2021	10%

This bill specifies that any amount of credit that exceeds the tax could be carried over to the following year, and succeeding two taxable years, until the credit is exhausted.

This credit would be repealed as of December 1, 2021.

IMPLEMENTATION CONSIDERATIONS

The department has identified the following implementation concerns. Department staff is available to work with the author’s office to resolve these and other concerns that may be identified.

This bill uses the term “cost,” which is broad and could include acquisition costs for an existing system, construction costs for a new system, maintenance costs, or ongoing costs associated with running the system, such as electricity, or the cost of required permits and inspections to install the system. If the author’s intention is to exclude these costs, the bill should be amended to specify the costs that would qualify for the credit.

This bill contains an undefined term, namely “irrigation system utilizing graywater.” Lack of definitions could cause disputes between taxpayers and the department

This department lacks the expertise to determine whether graywater or the irrigation system utilizing graywater meets the requirements set forth in the Water Code. Often credits requiring specialized expertise contain language that specifies an appropriate state agency for certification purposes. The author may wish to amend the bill to specify a certifying agency.

LEGISLATIVE HISTORY

AB 63 (Cogdill/Garcia, 2003/2004) would have allowed a credit for 25% of the cost of farm irrigation system improvements used to conserve water. AB 63 was held in the Assembly Revenue and Taxation Committee.

AB 2570 (Cogdill, 2001/2002), SB 435 (Monteith, 2001/2002), AB 1054 (Cogdill, 1999/2000), and SB 1974 (Poochigian, 1999/2000) would have allowed a credit for a percentage of the cost of farm irrigation system improvements. AB 2570 and AB 1054 were held in the Assembly Revenue and Taxation Committee. SB 435 and SB 1974 were held in the Senate Revenue and Taxation Committee.

SB 229 (McPherson, 1999/2000) would have allowed a tax credit equal to 15% of the cost to purchase and install qualified water application or distribution equipment that provided water conservation. AB 229 failed to pass out of the Legislature by the constitutional deadline.

OTHER STATES' INFORMATION

Florida, Illinois, Massachusetts, Michigan, Minnesota, and New York laws do not provide a credit comparable to the credit that would be allowed by this bill.

Arizona provides a credit equal to 25% of the costs of installing a graywater system in a taxpayer's residence, effective for taxable years 2007 through 2011. The credit cannot exceed \$1,000. To qualify for the credit, an application must be filed with the Arizona Department of Revenue (DOR). The DOR reviews each application and certifies the amount of the credit. Authorized credits are claimed on the taxpayer's income tax return, with any excess being carried forward to the following years until exhausted. Arizona has allocated \$250,000 to be used for certifications per calendar year.

FISCAL IMPACT

The present forms have limited space available for additional lines. If the changes proposed by this bill, along with other pending legislation, increase the forms from two to three pages, the department would incur costs of over \$2 million for revising the forms and instructions, printing, systems changes, processing, and storage. As the bill continues to move through the legislative process, costs will be identified and an appropriation will be requested.

ECONOMIC IMPACT

Revenue Estimate

Based on data and assumptions discussed below, this provision would result in the following revenue losses.

Estimated Revenue Impact of AB 1132 Effective for Tax Years BOA 1/1/2007 Assumed Enactment Date After 6/30/2007 (\$ in Millions)		
2007/08	2008/09	2009/10
<-\$0.5	-\$0.5	-\$1

This estimate does not consider the possible changes in employment, personal income, or gross state product that could result from this bill.

Revenue Discussion

The revenue impact of this bill would be determined by the amount of graywater tax credits applied to reduce personal and corporate tax liabilities. Industry contacts indicate the number of irrigation systems installed each year is approximately 150. This bill would likely increase the number of systems installed to several hundred per year.

The cost of a legal graywater irrigation system varies from approximately \$1,200 (for a small owner-installed system with cost limited to parts and permit) to several thousand dollars. The average cost of a single-family residential system, including labor, plumbing, and permit would be approximately \$5,000. Installation of a graywater irrigation system for large commercial, industrial, or multi-family locations would not cost substantially more. The cost of a maintenance contract for graywater irrigation systems is generally between \$30 and \$100 per month, depending on size, type, and location of the system. For a single-family home, the average cost of a maintenance contract is approximately \$50 per month; however, maintenance contracts are not required and may not be applicable to this credit, but are included in this estimate as this bill does not specify otherwise. Credits associated with ongoing maintenance of graywater irrigation systems would be approximately \$300 per system per year ($\$50 \times 12 \text{ months} \times 50\% \text{ credit} = \300) and would fluctuate based on the number of active systems, and the number of months the maintenance service would be used. Because maintenance contracts are not required, these costs may not apply.

This estimate assumes that 150 graywater irrigation systems would be installed during the 2007 tax year. We anticipate that fewer than 50% of taxpayers who install graywater irrigation systems would be aware of the credit for tax year 2007. Therefore, the amount of credit claimed in 2007 would be less than \$200,000. ($150 \text{ systems} \times \$5,000 \text{ average cost} \times 50\% \text{ credit} \times 50\% \text{ credits claimed} = \$187,500 \text{ credit for installation costs}$). The number of taxpayers who claim the credit would likely increase to 60% for tax year 2008 and 65% for tax year 2009 as awareness of the credit increases. Additionally, the number of graywater irrigation systems qualifying for this credit would likely increase to 300 systems for the 2008 tax year and 450 systems for the 2009 tax year.

This results in average available credits for installation of graywater irrigation systems of approximately \$750,000 per year during the first three years of the proposed credit. (300 systems x \$5,000 x 50% credit = \$750,000)

It is estimated that 90% of credits allowed would be claimed within the two-year carryover period. Tax year estimates have been converted to fiscal year cash flow estimates in the table above.

ARGUMENTS/POLICY CONCERNS

This bill would allow a credit in the taxable year in which the equipment is installed, which may be earlier than the taxable year in which the equipment is actually placed in service (i.e., used) in California. Most credits involving the installation and subsequent use of an item of property allow the credit to be claimed in the taxable year in which the placed in service date, for depreciation purposes, occurs. It is possible that a taxpayer could purchase and install the equipment, claim the credit, and resell the equipment to a third party that may also claim the credit. If this bill were to require that the equipment be placed in service in California, with an appropriate recapture provision to ensure continued operation in California for a specified (recapture) period, this potential problem would be avoided. The recapture provision would require the taxpayer to use the equipment for a certain length of time in this state or add all or some portion of the credit amount back to the tax liability.

This bill would allow taxpayers in certain circumstances to claim multiple tax benefits for the same item of expense. This bill should specify that the credit allowed under this section would be taken in lieu of any other credit or deduction allowed under other provisions for the same costs.

LEGISLATIVE STAFF CONTACT

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